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AVISON YOUNG (CANADA) INC.

Media Release

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**Media Relations:
Sherry Quan
(604) 647-5098 or (604) 726-0959
email: squan@ay-bc.com**

- Avison Young Year-End 2008 British Columbia Real Estate Investment Review, full report:
http://www.avisonyoung.com/library/pdf/Van_Research/AY_BCInvestReport_Yr-End08.pdf
- Property Photos and Head Shots for Media use:
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**Avison Young releases British Columbia Real Estate Investment Review:
2008 deals represent high water mark; global economic
downturn will take steam out of investment sales in 2009
*Private investors dominate buying and selling sides; office properties
most prominent assets traded in second half of 2008***

Vancouver, BC— The still-unfolding global credit crisis will take the steam out of British Columbia's commercial real estate investment sales in 2009, and indications are that capitalization rates will rise. Meanwhile, mid-2008 deals likely represented the high water mark for prices in this cycle.

These are some of the key trends noted in **Avison Young (Canada) Inc.'s *Year-End 2008 British Columbia Real Estate Investment Review***, released today. The semi-annual report tracks office, industrial and retail investment sales in BC greater than \$5 million.

During the second half of 2008, the total value of office, industrial and retail investment transactions amounted to \$734 million, up from \$535 million in the first half of 2008 and \$651 million in the latter half of 2007. This brought the total value of sales in 2008 to \$1.27 billion— up from \$967 million in 2007 and \$1 billion in 2006, but below the decade-high levels recorded in 2004 and 2005.

“What is important to note is the majority of the deals that completed in the second half of 2008 were negotiated in the early part of 2008— *before* Lehman Bros. filed for bankruptcy,” comments Avison Young (Canada) principal, **Michael Gill**. “Deals were already firm before

the credit markets imploded and, therefore, year-end sale prices did not reflect current values.”

Gill says most of 2008’s transactions represented sellers who wanted to take advantage of the market at its perceived peak. “Late 2008 was a period of financial deleveraging, extreme market volatility, and uncertainty. Deal activity is anticipated to decrease significantly in the first half of 2009 due to a slowdown in executive decision-making, market perception versus reality, and as the price expectation gap between buyers and sellers takes time to narrow,” explains Gill. “Although the underlying fundamentals of BC are among the strongest in North America, the crisis of confidence has permeated the commercial real estate market. In the final two months of 2008, many deals fell apart.”

“The last two to three years have been an anomaly,” adds Avison Young (Canada) principal, **Robert Gritten**. “Today, in early 2009, prime properties are witnessing a reduction in value as cap rates trend up. Less-than-prime properties and troubled properties are seeing a more significant reduction as cap rates move toward more historical levels.” He says upward pressure will be somewhat tempered due to the lack of available quality product. Moreover, while the average sale prices per square foot are still generally less than replacement costs, the gap is expected to narrow as land prices fall and construction costs continue to decrease.

The total number of transactions dipped from 38 in the first half of 2008 to 30 in the second half, bringing the total number of trades in 2008 to 68. This is up from 47 in 2007 and 54 in 2006. Average sale price in 2008 was \$18.7 million, down slightly from \$20.6 million in 2007. In 2008, the number of trades was evenly split between office (21), industrial (23) and retail (24). Office transactions accounted for 50% (or \$640 million) of the total dollar volume, while industrial contributed to 26% (or \$325 million) and retail accounted for 24% (or \$304 million).

Private investors dominated both the buying and selling sides in 2008. Office properties were at the forefront of asset types traded in the second half of last year, whereas industrial property trades were most prevalent in the first half. The sale of **Crestwood Corporate Centre** (Richmond, BC) for \$203.5 million was the largest deal of 2008 and accounted for 40% of the total value of office deals closed in the second half of 2008.

“Current challenges for buyers are finding vendors with lower (i.e. realistic) price expectations, and the lack of direction/benchmark pricing,” says Gill. “While many investors are sitting on the sidelines awaiting economic clarity, many also view the next 12 to 18 months as a great buying opportunity. However, redefined pricing will have to materialize first.” He adds that commercial property sales are anticipated to pick up later in 2009 as sellers become more realistic about valuations. Quality properties that would not normally be available are also now being offered to the market.

“Currently driving the market are vendors who are forced to sell because they need to raise equity to offset debt maturities. Other vendors may choose to sell to redeploy capital, or to

meet redemption calls from investors who wish to exit the commercial property market,” explains Gritten, who says the market is also witnessing a return to the traditional ‘list price and no bid date’ process. “Buyers are resisting pricing in upside potential for rental rates in their offerings due to concerns those rate increases will not materialize. Rental rates have peaked and are, in fact, on the downside.”

He continues: “Overall, investors requiring high leverage may be sidelined for now, but there are still plenty of interested buyers waiting in the wings. There is still considerable interest from private buyers and pension funds for prime assets, and the market is expected to witness an increase in funds from private buyers to real estate limited partnerships due to disillusionment with stock market investments.” Gritten says some vendors will also have to provide “take-back” financing to facilitate the completion of sales transactions.

“In spite of the tighter lending environment and cold recession winds from the U.S., the Canadian banking system is ranked the strongest in the world, large pools of capital continue to be available to qualified purchasers, the local commercial real estate market is not overbuilt, and vacancy levels still rank amongst the lowest in North America,” stresses Gill. “More assets are expected to be offered for sale in 2009 and deal activity is anticipated to pick up later in the year as the pricing gridlock begins to loosen and as debt becomes more readily accessible.”

Other survey highlights:

Buyer Profile:

As was the case in 2007, private investors dominated the buying side in 2008, accounting for 66% (45 of 68) of the deals and 40% (\$513 million) of the total \$1.27 billion in dollar volume. Institutional investors made up only 21% (14 of 68) of the trades in 2008 but outspent other buyer-types with 52% (\$664 million) of the total dollar volume. REITS came in third at \$45 million followed by public companies at \$29 million and government agencies at \$18 million. Financial institutions and foreign investors were non-participants in 2008.

While some institutional investors have been pushed to the sidelines because of redemption issues, institutions and private investors will generally continue to be prevalent players in BC’s investment market. The challenge in the marketplace is not so much the lack of buyers, but simply finding the right price point.

Seller Profile:

In 2008, private investors dominated the selling side both in number of transactions and dollar volume. Of the 68 deals closed last year, private investors represented 68% (46 of 68) of the sellers and 47% (\$592 million) of the total \$1.27 billion in dollar volume. Public companies accounted for 19% (13 of 68) of the sellers and 23% (\$297 million) of the total

dollar volume, while institutional sellers made up 12% (8 of 68) of the sellers and 28% (\$357 million) of the dollar volume.

Financial institutions, foreign investors and government agencies did not dispose of any office, industrial or retail properties greater than \$5 million in 2008. Concerned about their real-estate allocations, some institutional investors may curtail future investments due to decreasing values of their other investments (equities, bonds, mortgages etc.), which may now leave institutional investors over-allocated in real estate.

Office Investment Market:

The BC investment market in 2008 witnessed strong demand from investors to acquire office product, with office trades representing 31% (21 of 68) of the deals and 50% (or \$640 million) of the total dollar volume in 2008. This is more than double the \$267 million worth of office product traded in 2007. On a dollar volume basis, institutional investors dominated the office buying side in 2008, spending \$435 million, followed by private investors at \$164 million. Cap rates hit a market peak at sub 6% for quality product in 2008.

The availability of downtown class A investment properties was low the last three years. As of February 2009, the **Grosvenor** building (1040 West Georgia Street) has been under contract and is anticipated to close by mid March 2009. The transaction will provide a much anticipated benchmark price for the marketplace.

“In 2009, financing rollovers may cause some properties to come to the market and sellers still seeking yesterday’s price will have to re-set their expectations,” comments Avison Young (Canada) principal, **Bob Levine**. “Purchasers will challenge rental rate assumptions as office vacancies start to tick up in 2009. Also of concern will be the rise in the amount of sublease space offerings and potential tenant defaults.”

Levine continues: “Buyers have generally adjusted their cap rate expectations to above the 7% level for quality product and 8% or higher for class B and C product. However, Metro Vancouver’s relatively low office vacancy rate of 5.4% (2.5% downtown), the cost of debt—which while difficult to source is less than property yields, and controlled new development will help mitigate the rise of cap rates. Positive leverage is still very beneficial to the investor, ranging from 150 to over 400 basis points.”

Retail Investment Market:

In 2008, retail trades accounted for 35% (24 of 68) deals and 24% (\$304 million) of the total dollar volume. This is comparable to the \$282 million worth of retail product traded in 2007. Private investors spent the most on retail investment product in 2008 at \$194 million, followed by institutional investors at \$89 million.

“Interest dwindled considerably in the final quarter of 2008 due to uncertainty over values. Demand also started to shift to the established primary markets, leaving the secondary and tertiary markets mainly to local participants,” notes Gill. “While a number of institutions are out of the market, those that are active are moving slowly, which is providing the more nimble private investors an arena with little competition. As the retail sector has been badly bruised by the slowdown in consumer spending, some investors are shying away from retail assets altogether.”

In 2009, cap rates are anticipated to increase by 100 to 150 basis points for all retail types in BC’s primary markets and more in secondary and tertiary markets, according to Gill. “Well-situated retail strip centres leased to tenants in the food, drug and liquor categories as well as strong-performing restaurants (which are usually less affected by recessionary pressures than other retail categories) will be in most demand in 2009. Conversely, shopping centres tenanted to struggling US-based chains will face the most challenges.”

He adds: “What’s noteworthy is that the limited supply of retail product for lease in the Metro Vancouver area is providing established chains an opportunity to secure locations previously not available. As space becomes available, either through new construction, bankruptcy or lease termination, new occupants are arriving to fill the space.”

Industrial Investment Market:

In 2008, 34% (23 of 68) of the trades involved industrial product, which amounted to 26% (\$325 million) of the total dollar volume. This is nearly double the \$168 million worth of industrial properties sold in 2007. Private investors were at the forefront of buyers of industrial properties in 2008, investing \$156 million, followed by institutional investors at \$139 million.

Over the past couple of years, the average value of an industrial building has risen considerably, with offerings in mid-year 2008 reaching a record \$150 to \$170 per square foot (psf) for well-situated, single-tenant buildings. The strength of the strata market was significant in 2007 and 2008 with units asking \$180 to \$295 psf in 2008— up 60% over the previous three years and 100% over the previous five years.

“In 2009, average values are expected to drop moderately, with land and building costs decreasing. As cap rates and yields in 2008 represent pre-market collapse, an uptick of 50 to 150 basis points is anticipated in 2009, depending on location, quality and covenant strength,” says Gritten. “Affected by the lack of confidence, owner-operators are likely the most nervous right now, and user-demand is expected to remain soft until perception changes. Opportunities to acquire industrial properties not normally available will appear, but not at the discounts expected by most buyers.”

Nonetheless, the lack of industrial-zoned and serviced land, which pushed land values up 75% between 2004 and 2007 before cresting in 2008 and held vacancy in the low 2% range, will continue to drive strong demand in this sector, according to the report.

Founded in 1978, Avison Young is Canada's largest independently-owned commercial real estate services company. Comprising more than 500 real estate professionals in 12 offices across Canada and in Chicago, IL, the company provides value-added, client-centric investment sales, leasing, advisory, management and financial services to owners and users of commercial, industrial and multi-residential real estate properties.

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Editors/Reporters:

• **Avison Young Year-End 2008 British Columbia Real Estate Investment Review, full report:**

http://www.avisonyoung.com/library/pdf/Van_Research/AY_BCInvestReport_Yr-End08.pdf

• **Property Photos and Head Shots for Media use:**

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For further information/comment/photos:

• **Sherry Quan**, Director of Corporate Communications (B.C.), Avison Young (Canada) Inc.:
(604) 647-5098; cell: (604) 726-0959

• **Michael Gill**, Principal, Avison Young (Canada) Inc.: **(604) 687-7331**

• **Robert Gritten**, Principal, Avison Young (Canada) Inc.: **(604) 687-7331**

• **Robert Levine**, Principal, Avison Young (Canada) Inc.: **(604) 687-7331**

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